GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2007

Legislative Actuarial Note

HEALTH BENEFITS

BILL NUMBER: House Bill 2117 (First Edition)

SHORT TITLE: 28-Year State Law Enforcement Retirement.

SPONSOR(S): Representative Sutton

SYSTEM OR PROGRAM AFFECTED: Teachers' and State Employees' Comprehensive Major Medical Plan. On and after July 1, 2008 the Plan will be known as the *State Health Plan for Teachers and State Employees* (see Section 28.22A of Session Law 2007-323).

FUNDS AFFECTED: State General Fund, State Highway Fund, other State employer receipts; premium payments for dependents of active employees and retired employees of State agencies and universities, local public schools and local community colleges; premium payments for coverages selected by eligible former employees; premium payments for coverages selected by firefighters, rescue squad workers, members of the National Guard, and certain authorized local governments.

BILL SUMMARY: House Bill 2117 (1st Edition) proposes to allow law enforcement officers or eligible former law enforcement officers, whom are members of the Teachers' and State Employees' Retirement System, to retire on or after July 1, 2009 at the completion of 28-years of credible service with an unreduced service retirement benefit.

EFFECTIVE DATE: July 1, 2009

ESTIMATED IMPACT ON STATE: The proposed bill impacts the unfunded accrued actuarial liability for the State to provide health benefit coverage to retired State law enforcement officers.

The consulting actuary for the Teachers' and State Employees Comprehensive Major Medical Plan (Plan), Aon Consulting, estimates the proposed bill would increase the Annual Required Contribution by $800,000 to fund retired employee health benefit coverage on an actuarial basis. This reflects an increase of $500,000 in the normal cost to fund the benefit and an increase in the State's accrued liability of $8.3 million.

The consulting actuary for the General Assembly, Hartman & Associates, estimates the proposed bill would increase the Annual Required Contribution by $697,000 to fund retired employee health benefit coverage on an actuarial basis. This reflects an increase of $372,000 in the normal cost to fund the benefit and an increase in the State's accrued liability of $9.1 million.

ASSUMPTIONS AND METHODOLOGY:

General Assumptions for House Bill 2117 (1st Edition)

The Governmental Accounting Standards Board (GASB) has adopted new standards that significantly change how public employers must measure, expense and disclose obligations for other non-pension post-employment benefits. These new standards require public employers to use actuarial valuation methods and accrual accounting conventions — similar to the way pension obligations are measured and reported — to acknowledge the accumulation of Other Post-Employment Benefit (OPEB) liabilities.

The State's OPEB Actuarial Valuation Results for Calendar Year 2005

Aon Consulting issued an actuarial valuation of the State's OPEB liabilities for projected total retired employee healthcare benefits per the standards set forth in GASB Statement Nos. 43 & 45. This actuarial valuation estimates that the State has an Unfunded Accrued Actuarial Liability (UAAL) of $23.786 billion for total projected benefits for the calendar year period ending December 31, 2005. This number represents the $23.925 billion present value estimate of total OPEB liability for health benefit coverage earned by current retired employees, current active employees, and inactive former employees eligible to retire at some point in the future minus approximately $139.175 million in current assets as of the valuation date.

The 2005 actuarial valuation also reports the Annual Required Contribution (ARC) which includes the normal cost to fund the portion of health benefits earned by current employees for calendar year 2005 plus the amount required to amortize the already accrued unfunded liability over a period of 30 years. The ARC for the State based on the 2005 actuarial valuation is $2.39 billion annually. This number comprises $850 million to amortize a year of the existing UAAL plus $1.54 billion in normal costs for benefits earned by current employees. This ARC, based on a 4.25% discount rate, is projected to fund the State's accrued obligations plus normal costs. Amortization of the UAAL is based on a level percent of pay – the amount is projected to increase each year with increases in covered payroll.

The current percent of pay contribution rate for the 2005-2006 fiscal year is equal to 3.8% of payroll and has generated a reported $476.9 million for this fiscal period. An estimated 19.3% of payroll would be required to support the $2.39 billion ARC as determined in the State's actuarial valuation of retired employee health benefits.

Aon Consulting: The information below reflects the verbatim comments and assumptions of the Plan's consulting actuary with respect to the projection of funding need and estimate of cost reduction:

"Based on the bill attached, the eligibility for a pensions benefit was changed for law enforcement officers such that unreduced benefits are payable upon attaining 28 years of service. This will not affect the postretirement medical benefits available to these officers, but rather eligibility to receive benefits at earlier ages.

For purposes of comparison, we have calculated the effect of this change on the 12/31/2006 liability figures, as shown on page 1 of the 12/31/2006 actuarial report. The change increases the Unfunded Actuarial Accrued Liability by $8.3 million and increases the 2007 Normal Cost by $0.5 million. Overall, this change would increase the Annual Required Contribution by $0.8 million.

For the postretirement medical valuation, we have used the probabilities of retirement based on retirement assumptions used in the pension actuarial valuation. Prior to this change in unreduced retirement for law enforcement officers, the pension actuary assumed that the probability of retirement would increase the first year a participant becomes eligible for unreduced retirement. Our calculations presume that this assumption will not be changed. If these assumptions do change in the pension valuation, our results would change accordingly. The above effect of the change in unreduced retirement is based on a 4.25% discount rate, as applicable at 12/31/2006. The assumption change would have a lesser effect if the plan were funded so that a higher discount rate could be used."

Hartman and Associates: The information below reflects the verbatim assumptions of the General Assembly's consulting actuary with respect to the estimate of cost reduction:

"This estimate is based on the post-employment medical benefits actuarial valuation prepared as of December 31, 2005 and demographic data for law enforcement officers as of December 31, 2006. This data contained records for 3,435 state law enforcement officers, with usable data in 3,420 records. Costs are based on the projected unit credit funding method, amortization as a level percent of payroll, a 4.25% investment rate of return, and an initial medical trend of 11.0% grading to 5.0% over six years. Medical claim costs for retirees were based on Plan data for calendar year 2007 for the Smart Choice PPO option."

Summary Plan Information

The Plan operates on a self-funded basis funded through premium contributions, investment earnings and other receipts. As of October 1, 2006, the Plan operates an Indemnity plan and an optional Preferred Provider Option (PPO) plan. Effective July 1, 2008, the Plan will no longer operate the Indemnity Plan as a benefit option for plan members. The PPO plan offers three options to plan members that include: (1) a "basic" 70/30 plan that offers higher out-of pocket requirements in return for lower fully contributory dependent premiums; (2) a "standard" 80/20 plan; and (3) a 90/10 "plus" plan with enhanced benefits via lower out-of-pocket requirements as compared to the other PPO plan options. Participation in the plus plan requires employees and retired employees to make a partially contributory premium contribution to participate in this option. The basic and standard plans offer coverage to employees and retired employees on a noncontributory basis. Coverage for dependents under all plans is offered on a fully contributory basis.

Additional assumptions include Medicare benefit "carve-outs," cost containment strategies including prior approval for certain medical services, utilization of the "Blue Options" provider network, case and disease management for selected medical conditions, mental health case management, coordination of benefits with other payers, a prescription drug benefit manager with manufacturer rebates from formularies, and fraud detection, and other authorized actions by the Executive Administrator and Board of Trustees to manage the Plan to maintain and improve the Plan's operation and financial condition where possible. Claim cost trends are expected to increase at a rate of 9% annually according to the Plan's consulting actuary. Investment earnings are based upon a 4.5% return on available cash balances.

Financial Condition

Year-to-date Operating Results [1]

Through May 31, 2008, the Plan has an operating loss of approximately $38.7 million for the 2007-2008 fiscal year. Year-to-date operating losses in the Indemnity plan total $91.8 million versus a projected annual loss of $2.5 million. To date, these losses are partially offset by $53.1 million in operating gains under the PPO plans. The Plan as a result is operating substantially behind its projected annual operating income of $57.9 million for the 2007-2008 fiscal year. Based on actual results through May 2008, the Plan revised its projected income to reflect an estimated $63.9 million loss for the fiscal year, or a reduction of $121.8 million in projected income. The negative results experienced during the 2007-2008 fiscal year are expected to require the Executive Administrator of the Plan to implement additional cost saving programs for the balance of the 2007-2009 biennium.

Financial Projection (Revised June 2008)[2]

Combined Benefit Plan Components (Indemnity and PPO): For the fiscal year beginning July 1, 2007, the Plan is projected to start its operations with a beginning cash balance of $156.7 million. Receipts for the year are estimated to be $2.223 billion from premium collections, $51.8 million from Medicare Part D subsidies and $8.5 million from investment earnings for a total of $2.283 billion in receipts for the year. Claims payments from the Plan are expected to be $1.653 billion in medical claim payments, $548 million in pharmacy claim payments, plus $9.6 million in other cost adjustments for total net claims payments of $2.211 billion. Total disbursements of the Plan are expected to be $2.347 billion after adding total net claims payments plus $136.9 million in administration and claims processing expenses. For the fiscal year beginning July 1, 2007, the Plan is expected to have net operating income loss of approximately $63.9 million for the year. The Plan is also projected to have an available beginning cash balance of $92.8 million for the fiscal year beginning July 1, 2008. The Plan does maintain a claim stabilization reserve for claim cost fluctuations equal to 7.5% of annual claim payments without reserving additional funds for incurred but unreported claims.

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[1] Summary of Operations (Cash Basis Reporting), For the Period Ending May 2008, 2007-2008 Fiscal Year, Teachers' and State Employees Comprehensive Major Medical Plan.

[2] Aon Consulting, Consulting Actuary for the Teachers' and State Employees' Comprehensive Major Medical Plan, June 2008.

Indemnity Plan Component**:** For the fiscal year beginning July 1, 2007, the Indemnity plan started its operations with a beginning cash balance of $112.8 million. Receipts for the year are estimated to be $686.7 million from premium collections, $47.7 million from Medicare Part D subsidies and $4.1 million from investment earnings for a total of $738.5 million in receipts for the year. Claims payments from the Indemnity Plan are expected to be $545.1 million in medical claim payments, $232 million in pharmacy claim payments, minus $1.3 million in other cost adjustments for total net claims payments of $775.8 million. Total disbursements of the Indemnity plan are expected to be $837.9 million after adding total net claims payments plus $62.1 million in administration and claims processing expenses. For the fiscal year beginning July 1, 2007, the Indemnity plan is expected to have net operating income loss of approximately $99.4 million for the year. The Indemnity plan is projected to have an ending cash balance of $13.4 million for the fiscal year ending June 30, 2008. The Indemnity plan as a benefit plan option will cease to exist on July 1, 2008.

PPO Plans Component**:** For the fiscal year beginning July 1, 2007, the consolidated PPO plans started operations with a beginning cash balance of $43.9 million. Receipts for the year are estimated to be $1.537 billion from premium collections, $4.1 million from Medicare Part D subsidies and $4.4 million from investment earnings for a total of $1.546 billion in receipts for the year. Claims payments from the Plan are expected to be $1.108 million in medical claim payments, $316 million in pharmacy claim payments, plus $10.9 million in other cost adjustments for total net claims payments of $1.435 billion. Total disbursements of the Plan are expected to be $1.510 billion after adding total net claims payments plus $74.8 million in administration and claims processing expenses. For the fiscal year beginning July 1, 2007, the PPO plans are expected to have net operating income of approximately $35.6 million for the year. The PPO plans are also projected to have an available beginning cash balance of $79.5 million for the fiscal year beginning July 1, 2008.

Enrollment Data as of December 31, 2007

I.	No. of Participants	Indemnity Plan	PPO Options	Total	Percent of Total
	Actives				
	Employees	68,745	253,572	322,317	50.0%
	Dependents	21,031	135,744	156,775	24.3%
	Sub-total	89,776	389,316	479,092	74.4%
	Retired				
	Employees	85,753	55,948	141,701	22.0%
	Dependents	7,859	11,611	19,470	3.0%
	Sub-total	93,612	67,559	161,171	25.0%
	Former Employees with Continuation Coverage				
	Employees	682	1,022	1,704	0.3%
	Dependents	226	616	842	0.1%
	Sub-total	908	1,638	2,546	0.4%
	Firefighters, Rescue Squad & National Guard				
	Employees	3	-	3	0.0%
	Dependents	-	-	-	0.0%
	Sub-total	3	-	3	0.0%
	Local Governments				
	Employees	16	1,082	1,098	0.2%
	Dependents	-	459	459	0.1%
	Sub-total	16	1,541	1,557	0.2%
	Total	184,315	460,054	644,369	
	Percent of Total	28.6%	71.4%	100.0%	100.0%

II.	Retiree Enrollment by Category	Indemnity Plan	PPO Options	Total
	Non-Medicare Eligible	25,859	34,711	60,570
	Medicare Eligible	67,753	32,848	100,601
	Total	93,612	67,559	161,171

Percent by Category (Retiree)	Indemnity Plan	PPO Options	Total
Non-Medicare Eligible	27.6%	51.4%	37.6%
Medicare Eligible	72.4%	48.6%	62.4%
Total	100.0%	100.0%	100.0%

Enrollment Data Continued

III. Enrollment by Age	Indemnity Plan	PPO Options	Total
29 & Under	25,706	147,450	173,156
30 to 44	23,965	105,402	129,367
45 to 54	28,204	89,488	117,692
55 to 64	40,880	82,975	123,855
65 & Over	65,560	34,739	100,299
Total	184,315	460,054	644,369

Percent Enrollment by Age	Indemnity Plan	PPO Options	Total
29 & Under	13.9%	32.1%	26.9%
30 to 44	13.0%	22.9%	20.1%
45 to 54	15.3%	19.5%	18.3%
55 to 64	22.2%	18.0%	19.2%
65 & Over	35.6%	7.6%	15.6%
Total	100.0%	100.0%	100.0%

IV. Enrollment by Sex	Indemnity Plan	PPO Options	Total
Female	117,283	284,899	402,182
Male	67,032	175,155	242,187
Total	184,315	460,054	644,369

Percent Enrollment by Sex	Indemnity Plan	PPO Options	Percent of Total
Female	63.6%	61.9%	62.4%
Male	36.4%	38.1%	37.6%
Total	100.0%	100.0%	100.0%

SOURCES OF DATA:

-Actuarial Note, Hartman & Associates, House Bill 2117 (1st Edition), June 23, 2008, original of which is on file in the General Assembly's Fiscal Research Division.

-Actuarial Note, Aon Consulting, House Bill 2117 (1st Edition), June 24, 2008, original of which is on file with the Comprehensive Major Medical Plan for Teachers and State Employees and the General Assembly's Fiscal Research Division.

TECHNICAL CONSIDERATIONS: None

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